

**GLOBAL AVIATION ASSOCIATES, LTD.**

**ga<sup>2</sup>**

**Statement of**

**Jon F. Ash  
Managing Director**

**Before the**

**NATIONAL COMMISSION TO ENSURE CONSUMER INFORMATION AND  
CHOICE IN THE AIRLINE INDUSTRY**

**JULY 2002**

MR. CHAIRMAN, MEMBERS OF THE COMMISSION, MY NAME IS JON ASH. I AM THE MANAGING DIRECTOR OF GLOBAL AVIATION ASSOCIATES, LTD., (ga<sup>2</sup>) A WASHINGTON, D.C. BASED AVIATION CONSULTING FIRM SPECIALIZING IN STRATEGIC, ECONOMIC, REGULATORY, AND AEROPOLITICAL CONSULTING TO AIRLINES, AIRPORTS, MANUFACTURERS, AND VENDORS TO THE INDUSTRY. WE ALSO ADVISE AND COUNSEL GOVERNMENT OFFICIALS FROM TIME TO TIME, GENERALLY ON A PRO BONO BASIS.

I HAVE 35 YEARS OF EXPERIENCE IN THE COMMERCIAL AVIATION INDUSTRY, 20 OF WHICH WAS WITH A MAJOR U.S. AIR CARRIER. DURING THAT TWENTY YEARS, I WAS VARIOUSLY RESPONSIBLE AS A STAFF OFFICER AND LATER CORPORATE OFFICER FOR ECONOMIC, FINANCIAL, AND LONG RANGE PLANNING; SALES, INCLUDING RELATIONSHIPS WITH TRAVEL AGENCIES; RESERVATIONS SERVICES, AND AIRPORT OPERATIONS. I ALSO SERVED AS CORPORATE VICE PRESIDENT, GOVERNMENT AND INTERNATIONAL AFFAIRS. IN PARTICULAR, DURING MY TERM AS REGIONAL VICE PRESIDENT, I SPENT A CONSIDERABLE AMOUNT OF TIME WITH TRAVEL AGENCIES AND TRAVEL AGENT ISSUES.

DURING THE PAST FIFTEEN YEARS IN CONSULTING I HAVE DIRECTED NUMEROUS STRATEGIC, ECONOMIC, AND FINANCIAL STUDIES FOR VARIOUS CLIENTS.

IN LATE 2000, I WAS RETAINED BY ORBITZ TO UNDERTAKE A STUDY OF THE CURRENT STATE OF TRAVEL DISTRIBUTION. THAT STUDY WAS PUBLISHED IN FEBRUARY 2001 AND IS ENTITLED, THE HISTORY AND OUTLOOK FOR TRAVEL DISTRIBUTION IN THE PC-BASED INTERNET ENVIRONMENT. IT IS ENCLOSED AS “EXHIBIT A” TO MY TESTIMONY.

JUST THIS MONTH, WE COMPLETED AN UPDATE OF THAT STUDY WITH A PARTICULAR EMPHASIS ON EVOLVING AND SHIFTING CHANNELS OF TRAVEL DISTRIBUTION; COMPETITION AND COST WITHIN AND BETWEEN THOSE CHANNELS; THE ON-GOING IMPACT OF GLOBAL DISTRIBUTION SYSTEMS (GDSS) ON CARRIER STRATEGIES WITH RESPECT TO CHANNEL SHIFTS AND COSTS. THAT STUDY, ENTITLED THE ECONOMICS OF THIRD PARTY TRAVEL AGENT WEBSITES, IS ENCLOSED AS “EXHIBIT B.”

THE PRINCIPAL CONCLUSIONS THAT WE HAVE DRAWN THROUGH THESE TWO STUDIES ARE:

- 1. THE TRAVEL AGENCY COMMUNITY WILL REMAIN HEALTHY AND ECONOMICALLY VIABLE, ALTHOUGH THE TREND TOWARD CONCENTRATION WILL PROBABLY CONTINUE. THAT RESULT IS A NATURAL OUTGROWTH OF THE FREE DEREGULATED MARKET.**

2. **SUPPLIER AND THIRD PARTY TRAVEL AGENT WEBSITES WILL CONTINUE TO ATTRACT INCREASING PROPORTIONS OF THE CONSUMER TRAVEL MARKET.**
3. **GLOBAL DISTRIBUTION SYSTEMS, AS THE SEARCH AND BOOKING ENGINE BACKBONE OF TRAVEL AGENCY SALES WILL CONTINUE TO BE AT LEAST SOMEWHAT MARGINALIZED BY THEIR RELATIVE INEFFICIENCY AND HIGH COST. ON THE OTHER HAND, THEY ARE WELL POSITIONED TO SURVIVE, GIVEN THEIR CURRENT POSITION AS AN INTEGRAL CONNECTOR BETWEEN THE CUSTOMER AND SUPPLIER.**

NOW, LET ME ADDRESS EACH OF THESE CONCLUSIONS IN ORDER.

FIRST, THE TRAVEL AGENCY COMMUNITY WILL REMAIN HEALTHY AND ECONOMICALLY VIABLE, ALTHOUGH THE TREND TOWARD CONCENTRATION WILL PROBABLY CONTINUE. THAT RESULT IS A NATURAL OUTGROWTH OF THE FREE DEREGULATED MARKET.

I HAVE DEALT DIRECTLY AND INDIRECTLY WITH THE AGENCY COMMUNITY FOR 35 YEARS. DURING THAT TIME, THERE HAVE BEEN NUMEROUS OCCASIONS ON WHICH THE AGENCY COMMUNITY HAS CONCLUDED THAT AIR CARRIER AND OTHER MARKET PLACE ACTIVITIES WOULD SERIOUSLY JEOPARDIZE THE HEALTH OF THE AGENCY INDUSTRY. WHILE RECENT EVENTS, INCLUDING THE INCREASING RELIANCE ON THE INTERNET AND THE ELIMINATION OF COMMISSIONS ON U.S. SALES HAVE HAD A PROFOUND IMPACT ON MANY BUSINESSES, THERE IS EVIDENCE THAT THE “INDUSTRY” IN ITS BROADEST SENSE, WILL REMAIN HEALTHY, NOTWITHSTANDING THE POTENTIAL FAILURE OF A NUMBER OF AGENCIES THAT MAY NOT BE ABLE TO ADAPT TO THE NEW CIRCUMSTANCES. IT SEEMS TO ME THAT ONE HAS TO ASK THE QUESTION, “WHY SHOULD THE

AGENCY COMMUNITY BE DIFFERENT FROM THE AIRLINE INDUSTRY OR OTHER BUSINESSES WHERE SOME FAIL AND SOME SUCCEED?”

INTERESTINGLY, THE 2001 U.S. CONSUMER TRAVEL SURVEY CONDUCTED BY NFO PLOG RESEARCH, INC., CONCLUDES THAT THE INTERNET HAS SHORTCOMINGS, INCLUDING “TOP AMONG THEM IS THE LACK OF PERSONAL SERVICE THAT A TRAVEL AGENT CAN PROVIDE.” THE SURVEY CONTINUES, “TWO OUT OF EVERY FIVE (40%) U.S. TRAVELERS REPORT USING AN AGENT AT LEAST ONCE WITHIN THE PAST YEAR. WHILE THIS FIGURE INDICATES THAT AGENTS ARE REACHING A HEALTHY PORTION OF THE U.S. TRAVEL MARKET, IT ALSO MARKS A DECLINE IN MARKET SHARE BY FIVE PERCENTAGE POINTS FROM 1999 AND 1998....” CONTINUING, “A CLOSER LOOK AT INTERACTIVE TRAVELERS UNCOVERS A TREND THAT FAVORS AGENTS: AS A GROUP, SO-CALLED INTERACTIVE OR ONLINE AIR TRAVELERS CONSTITUTE ONE OF THE HEAVIEST USERS OF AGENCY SERVICES...”

SECOND, SUPPLIER AND THIRD PARTY TRAVEL AGENT WEBSITES WILL CONTINUE TO ATTRACT INCREASING PROPORTIONS OF THE CONSUMER TRAVEL MARKET.

TRAVEL WEBSITES OFFER TWO VERY REAL ADVANTAGES TO THE ONLINE CONSUMER. FIRST, A VAST ARRAY OF TRAVEL OPTIONS AND TRAVEL SITES WITH SOPHISTICATED AND USER FRIENDLY SEARCH ENGINES, AND SECOND, CONTROL.

THE ONLINE TRAVELER HAS THE OPPORTUNITY TO UTILIZE TRANSPARENT SITES SUCH AS ORBITZ, TRAVELOCITY, AND EXPEDIA AND OPAQUE SITES SUCH AS HOTWIRE AND PRICELINE. IN ADDITION, WITH SCREEN SCRAPERS SUCH AS SIDESTEP THAT IMBED ON YOUR PC, THE CONSUMER CAN DETERMINE WHETHER THE SERVICE AND PRICE OFFERED BY ORBITZ, FOR EXAMPLE, IS REALLY THE BEST OPTION SINCE THE IMBEDDED SIDESTEP WILL PROMPT A COMPARISON OF ALTERNATIVE FARES.

OVERALL, THE INTERNET HAS BECOME A SIGNIFICANT FACTOR IN TRAVEL. ACCORDING TO PHOCUSWRIGHT, INC., ONLINE TRAVEL WILL REPRESENT 15% OF ALL TRAVEL BOOKED IN 2002. ONLINE AGENCY SITES WILL SELL HALF OF THAT 15% TOTAL. FUTURE GROWTH IS EXPECTED TO BE IN THE 30% PER ANNUM RANGE.

WITH RESPECT TO ORBITZ AND HOTWIRE, PHOCUSWRIGHT OBSERVES, “ALTHOUGH ORBITZ AND HOTWIRE CONTINUE TO PLAY A KEY ROLE IN LOWERING AIRLINE DISTRIBUTION COSTS, THE REALITY IS THAT AIRLINES HAVE THEIR OWN BRANDED WEB SITES AND LUCRATIVE NEGOTIATED-RATE DISTRIBUTION DEALS WITH OTHER ONLINE AGENCIES.” IN ADDITION, LOW FARE CARRIERS IN PARTICULAR ARE VERY COST FOCUSED. JETBLUE HAS 92% OF ITS TRAVEL IS BOOKED

DIRECTLY, AND 44% ONLINE. SOUTHWEST ALSO HAS A VERY HIGH PERCENTAGE OF ONLINE BOOKING.

THERE IS LITTLE DOUBT THAT WHILE THE MAJOR NETWORK CARRIERS ARE ENCOURAGING WEBSITE BOOKING, INCLUDING THIRD PARTY AGENCY SITES, THEY WOULD NOT BE ADVERSE TO SEEING EVEN MORE DIRECT BOOKING ON THEIR OWN SUPPLIER SITES. WHY NOT, THE COST DIFFERENCE IS NOT INSIGNIFICANT. EVEN WITH THE ELIMINATION OF COMMISSIONS ON U.S. SALES, THERE ARE STILL OVERRIDE AND INCENTIVE COMMISSIONS AND WHEN COMBINED WITH A BOOKING FEE OF OVER \$4 PER SEGMENT, THESE TWO COSTS OF DISTRIBUTION ALONE CAN PRODUCE AN EXPENSE OF UP TO \$20 PER PASSENGER. A DIRECT SUPPLIER BOOKING IS LIKELY TO COST LESS THAN \$5-\$6.

IN ITS RECENT STUDY, ONLINE CORPORATE TRAVEL 2001-2003, PHOCUSWRIGHT FINDS “THE COST EFFICIENCIES ASSOCIATED WITH USING ONLINE BOOKING TOOLS HAS SHIFTED CORPORATE TRAVEL FROM A SUPPLY-DRIVEN TO DEMAND DRIVEN MARKETPLACE, WITH GREATER EMPHASIS ON A CORPORATION’S TRAVELERS AND THEIR NEEDS.” THE TRENDS ARE CLEAR, AND THEY ARE DRIVEN BY THE PRICE/SERVICE QUALITY EQUATION.

WHAT IS NOT YET CLEAR IS WHICH BUSINESS ENTITIES WILL BE THE “DISINTERMEDIATED,” AND WHICH WILL BE “RE-INTERMEDIATED.” THAT

WILL BE A FUNCTION OF BUSINESS DECISIONS BY AIRINES, AGENCIES, TRAVEL MANAGERS, AND OTHER SUPPLIERS AND SELLERS OF TRAVEL SERVICES. THE CONSUMER WILL VOTE WITH HIS OR HER POCKETBOOK AS TO WHETHER THERE IS “ADDED VALUE.”

THIRD, GLOBAL DISTRIBUTION SYSTEMS, AS THE SEARCH AND BOOKING ENGINE BACKBONE OF TRAVEL AGENCY SALES WILL CONTINUE TO BE AT LEAST SOMEWHAT MARGINALIZED BY THEIR RELATIVE INEFFICIENCY AND HIGH COST. ON THE OTHER HAND, THEY ARE WELL POSITIONED TO SURVIVE, GIVEN THEIR CURRENT POSITION AS AN INTEGRAL CONNECTOR BETWEEN THE CUSTOMER AND SUPPLIER.

THE U.S. AIRLINE INDUSTRY LOST OVER \$7 BILLION IN 2001, AND WILL LOSE OVER \$4 BILLION IN 2002. ADDITIONALLY, PASSENGERS ARE INCREASINGLY FINDING THE BROAD ARRAY OF FARES READILY AVAILABLE THROUGH A MYRAID OF SOURCES WHERE COMPARISON SHOPPING CAN BE ACCOMPLISHED, INCLUDING ON-LINE WITH SOFTWARE SUCH AS SIDESTEP. THIS TREND, COMBINED WITH THE GROWTH OF LOW FARE CARRIERS, HAS PRODUCED AN ENVIONRMENT WHEREIN THE AVERAGE FARE PAID BY THE U.S. TRAVELER HAS REMAINED UNCHANGED OVER THE PAST ELEVEN YEARS. THE NET PASSENGER YIELD TO THE MAJORS OF 13.12 CENTS IN 2001 WAS 6/100THS OF A CENT LOWER THAN THE 13.18 CENT YIELD OF 1990.

THUS, THE ECONOMICS OF THE INDUSTRY DICTATE THAT CARRIERS FOCUS ON COST, AND THERE ARE TWO PRIMARY ELEMENTS RECEIVING SERIOUS ATTENTION. ONE IS LABOR, AND THE SECOND, DISTRIBUTION



COSTS. IN THIS REGARD, WE FOUND THAT THE RANGE OF COSTS FOR DISTRIBUTION WAS BETWEEN 3% AND 20% OF EACH REVENUE DOLLAR, PRE-MARCH 2002 WHEN COMMISSIONS WERE ELIMINATED. WHEN DISECTING THIS COST ELEMENT, AGENT COMMISSIONS ACCOUNTED FOR ROUGLY 6%--ALTHOUGH IN THE PAST IT HAD BEEN AS HIGH AS 12% ON AVERAGE. GDS BOOKING FEES ACCOUNT FOR ANOTHER 3%, AND UP TO 6% FOR THE LOW FARE POINT TO POINT CARRIER. THUS, CARRIERS SUCH AS SOUTHWEST AND JETBLUE ARE USING EVERY POSSIBLE VEHICLE TO DRIVE CUSTOMER BOOKINGS TO THEIR WEBSITES...AND WITH MEASURABLE SUCCESS. JETBLUE CUSTOMERS MAKE OVER 92% OF THEIR BOOKINGS DIRECT, AND 44% OF THOSE BOOKINGS ARE ON THE JETBLUE WEBSITE. SOUTHWEST IS ALMOST AS SUCCESSFUL.

THE MAJOR NETWORK CARRIERS CREATED HOTWIRE AND ORBITZ TO ACCOMPLISH THE PRIMARY OBJECTIVES OF ENHANCING COMPEITION AND REDUCING THE COST OF DISTRIBUTION. WHILE CREATING MORE OUTLETS WITHIN THE INTERNET CHANNEL, THESE CHANNELS ARE CLEARLY NOT AS INEXPENSIVE AS DIRECT BOOKING. ON THE OTHER HAND, THEY ARE CONSIDERABLY LESS EXPENSIVE THAN THE MARKET DOMINANT GDS DRIVEN TRAVELOCITY AND EXPEDIA.

WE FOUND THAT BOOKING FEES ARE NOW \$4.36 PER SEGMENT, ON AVERAGE, OR 3.0% OF THE AVERAGE TICKET PRICE. THIS PRODUCES AN

INDUSTRY BILL OF \$2.2 BILLION PER ANNUM. AS NOTED RECENTLY BY DAVID HILFMAN, CONTINENTAL'S VICE PRESIDENT OF MULTINATIONAL SALES AND REVENUE PROGRAMS, "THE HIGH COST OF PROCESSING TICKETS THROUGH THE CRS IS THE BIGGEST ISSUE FOR US RIGHT NOW." HE WENT ON TO NOTE, "CONTINENTAL IS PAYING GDS BOOKING FEES OF UP TO \$17 PER PASSENGER."

THE ORBITZ CHARTER ASSOCIATE, WITH BOOKINGS DRIVEN OVER WORLDSPAN, AND AFTER REBATE, INCURS A BOOKING FEE COST OF ONLY \$2.07. WERE BOOKINGS SHIFTED FROM THE "AVERAGE" TO THE ORBITZ LEVEL, THE INDUSTRY COULD SAVE ROUGLY \$1 BILLION PER ANNUM. WHILE THAT MAY SOUND LIKE A LARGE NUMBER, FORRESTER RESEARCH HAS PREDICTED THAT THE ULTIMATE SOLUTION TO THE HIGH GDS BOOKING FEES, DIRECT CONNECT, WILL SAVE THE INDUSTRY \$1.4 BILLION.

IN VIEW OF THESE FACTS AND CIRCUMSTANCES, IS IT ANY WONDER THAT AIRLINES ARE WORKING DILLIGENTLY TO MOVE MORE AND MORE TRAFFIC TO THE INTERNET, AND MOST PARTICULARLY AWAY FROM OUTLETS THAT REQUIRE THE GDS BACKBONE?

BY THE SAME TOKEN, IT IS ALSO CLEAR FROM AIRLINE EXECUTIVES STATEMENTS, AND TESTIMONY BEFORE THIS COMMISSION, THAT THE

TRAVEL AGENT WILL CONTINUE TO BE AN INTEGRAL PART OF THE DISTRIBUTION SYSTEM. THAT VIEW IS EQUALLY SUPPORTED BY THE PLOG 2001 CONSUMER TRAVEL SURVEY WHEN IT OBSERVES, "...DATA ON CONSUMER LOYALTY TO TRAVEL AGENTS AND THEIR FREQUENCY OF AGENCY PATRONAGE YIELD TWO OVERRIDING—AND HEARTENING—CONCLUSIONS: AGENTS ARE GOOD AT THEIR JOBS AND THERE IS SIGNIFICANT UNTAPPED MARKET POTENTIAL IN THEIR CURRENT CLIENT BASE."

IN SUMMARY, OUR RESEARCH DRAWS US TO THREE PRIMARY CONCLUSIONS REALTIVE TO THE DEVELOPMENT OF THE INTERNET AND THE TRAVEL AGENCY COMMUNITY.

**THE TRAVEL AGENCY COMMUNITY WILL REMAIN HEALTHY AND ECONOMICALLY VIABLE, ALTHOUGH THE TREND TOWARD CONCENTRATION WILL PROBABLY CONTINUE. THAT RESULT IS A NATURAL OUTGROWTH OF THE FREE DEREGULATED MARKET.**

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I BELIEVE THAT THESE CIRCUMSTANCES WILL DELIVER GREAT REWARDS TO THE CONSUMER AND SELECTED BUSINESS ENTITIES THAT CAN

PROVIDE “ADDED VALUE” AT REASONABLE COSTS. HOWEVER, THE MARKET AS WE SEE IT WILL ALSO DELIVER HARSH PUNISHMENT TO THOSE THAT ARE UNWILLING OR UNABLE TO PROVIDE THE CONSUMER WITH VALUE. IN SOME CASES, THE VALUE WILL BE PRICE DRIVEN AND IN OTHER CASES, SERVICE DRIVEN, BUT IT MUST BE THERE. OTHERWISE, THE AIRLINE, TRAVEL AGENCY, OR OTHER INTERMEDIARY WILL PERISH, AS IT SHOULD.

IT IS THE ROLE OF GOVERNMENT TO PROTECT AND ENHANCE OPTIONS AND OPPORTUNITIES FOR THE CONSUMER. IT IS EQUALLY NOT THE ROLE OF GOVERNMENT TO PROTECT INEFFICIENT BUSINESSES, BUT TO ALLOW THE MARKETPLACE AND CONSUMERS HANDLE THAT TASK. AS NOTED IN ITS REPORT TO CONGRESS “EFFORTS TO MONITOR ORBITZ,” DATED JUNE 27, 2002, THE DEPARTMENT OF TRANSPORTATION OBSERVED, “GOVERNMENT INTERVENTION IN THE MARKETPLACE SHOULD BE DESIGNED TO CORRECT A FAILURE OF MARKET FORCES, NOT TO REPLACE OR PRE-EMPT THEM IN WAYS THAT COULD POTENTIALLY STIFLE INNOVATION.”

THANK YOU FOR THE OPPORTUNITY TO SUBMIT THIS TESTIMONY.